

Price cap regulation is intended to create incentives for LECs to innovate through the deployment of new technologies and to exploit those technologies through the development of new services. If the Part 69 rules remain unchanged, then the effect of the price cap incentives is diminished because the Part 69 rules operate to delay, as in the case of common channel signalling, the introduction of new and innovative service capabilities.

In the future, the chilling effects on innovation of the Part 69 rules will likely be far more pervasive. The NII will require considerable investment in new telecommunications facilities and technologies. In order for LECs to make the investment, they must have a reasonable expectation that they will have an opportunity in the marketplace to offer new services which, if successful, will generate new profits. If the Commission, however, retains access rules which will not permit LECs to introduce new services that can use the NII without first going through rulemaking or waiver proceedings, then the Commission creates a regulatory uncertainty surrounding the economic viability of the NII. The Commission can not expect the types of new investment necessary for the NII to be undertaken without first resolving that regulatory uncertainty.

The Commission has identified important and expansive goals that it intends to pursue through price regulation. The Part 69 rules should not be an impediment to achievement of the Commission's objectives. After ten years of severely constraining LECs, the Commission must reassess the purpose of maintaining these restrictions, particularly in light of other changes that have occurred. These limitations are not compatible with incentive regulation; they are not compatible with the transition to a competitive environment; and they are not compatible with a rapid deployment of state of the art

technologies. Accordingly, the Commission should amend its Part 69 rules to remove the rate structure requirements associated with switching and common line elements.^{132/}

Baseline Issue 10: Sales and Swaps of Exchanges

Baseline Issue 10:

Whether, and how, the process for granting waivers of the price cap rules governing mergers and acquisitions or the price cap rules themselves should be revised so as to prevent unreasonable cost shifting and maintain the efficiency incentives of the LEC price cap plan.

The Notice reaffirms the Commission's belief that its previous waivers of rules prohibiting sales and swaps which move exchanges out of price caps will yield benefits in efficiency, service quality and infrastructure development. Nevertheless, the Commission is concerned that such waivers may increase access rates unnecessarily, and may increase burdens on FCC support programs, such as Universal Service Fund ("USF") subsidies.^{133/}

On this issue, BellSouth believes that there should be no change either in the price cap rules or in the current process for granting waivers of the price cap rules that govern mergers or acquisitions. The price cap tariff review process and exogenous cost adjustments are capable of handling any PCI adjustments that the Commission deems appropriate. Furthermore, in view of the acknowledged benefits that particular acquisitions, mergers or other transactions can bring to consumers, it is important for the Commission to maintain a case-by-case approach without making broad or unnecessary regulatory pronouncements that could unnecessarily deprive the public of such benefits.

^{132/} By rate structure rules, BellSouth means those rules that either define or limit rate elements, cost recovery, or rate averaging.

^{133/} See Notice at 38, ¶ 88.

Baseline Issue 11: Other Revisions to the Current LEC Price Cap Plan

Baseline Issue 11:

Whether the Commission should adopt revisions to the baseline LEC price cap plan in areas other than those specifically discussed in this Notice.

BellSouth supports USTA's recommendation that the Commission substitute the gross domestic product - price index (GDP-PI) for the gross national product - price index (GNP-PI) as the inflation measure in the price cap formula. As USTA has explained, beginning in 1991, the U.S. Department of Commerce Bureau of Economic Analysis (BEA) discontinued publication of the 45-day estimate of the GNP-PI, substituting a 45-day estimate of the GDP-PI. Because BEA's 75-day estimate of the GNP-PI is not released in time for incorporation in the price cap LECs' annual access tariff filings, most LECs, including BellSouth, now use the 45-day GDP-PI estimate in their April filings, and then make an administratively burdensome "true-up" to reflect the 75-day GNP-PI estimate in a June filing.

Given that the two indices have been virtually identical for more than a decade, BellSouth believes that substitution of the GDP-PI for the GNP-PI is in the public interest. This small but significant change will reduce administrative burdens on the LECs, the Commission and other interested parties, and will have little prospect of harming consumers.

Baseline Issue 12: Relationship to Other Proceedings

Baseline Issue 12:

How the Commission should coordinate the LEC price cap review and any changes in the LEC price cap plan with other proceedings and proposals.

This proceeding addresses numerous complex issues. The baseline issues that the Commission has identified deal with core aspects of the price cap plan. The transitional issues recognize the rapidly changing environment in the telecommunications marketplace

and the corresponding need to structure a regulatory approach that can accommodate as well as facilitate competition.

In response to the Commission's baseline issues, BellSouth has recommended several changes to the price cap rules that would significantly improve the performance of the plan. The Commission should afford these recommendations the highest priority and should implement these changes by January 1, 1995. Also in response to baseline issues, BellSouth has proposed certain changes to Part 69, the access charge rules. Essentially, BellSouth's proposal would remove the current restrictions that prescribe the rate structure for switching and common line. These recommended changes, while not part of the price cap rules, would significantly enhance price cap performance by removing regulatory barriers to innovation and new service development.

The baseline modifications to the price cap rules are needed to improve the performance of the plan and to assure that the plan continues to grow in achieving the Commission's objectives. As recognized in the Notice, competition for exchange access services is developing rapidly. Accordingly, the price cap plan must be structured to accommodate competition. In response to the transition issues presented in the Notice, BellSouth proposes a framework which relaxes regulation commensurate with the presence of competition. As discussed further below in response to the transition issues, this framework would lead to streamlined regulation for access services subject to effective competition. Given the speed with which the competitiveness of the marketplace is increasing, it is imperative that this framework be adopted and implemented on an expedited basis.

While coordinating the resolution of baseline issues and transition issues is important to the development of an efficient price cap plan, there are other non-price cap matters that must be resolved and that are essential to the achievement of the Commission's long-term policy objectives. BellSouth recommends, for example, that the Commission

immediately commence a proceeding to address universal service issues. Such a proceeding is long overdue, of critical importance, and could affect dramatically the competitiveness of the exchange access marketplace. It is critical that the Commission develop an approach that ensures universal service but that in implementation is competitively neutral.

The Commission has several proceedings pending that will be greatly impacted by the outcome of this proceeding. For example, in CC Docket No. 93-179, the Commission sought comment on whether an "add back" mechanism should be added to the sharing mechanism applicable to price cap LECs.^{134/} If the Commission accepts BellSouth's recommendations in this docket and eliminates the sharing and lower formula adjustment mechanisms, that proceeding would be rendered moot.

In the Commission's Depreciation Simplification proceeding, CC Docket No. 92-296, the Commission adopted a Price Cap Carrier Option for AT&T, but refused to extend that same option to the price cap LECs, largely because of concerns about the impact of that option on the sharing mechanism.^{135/} Petitions for Reconsideration of that decision are still pending before the Commission. If the Commission eliminates the sharing mechanism in this proceeding, it should grant the Petitions for Reconsideration and extend the Price Cap Carrier Option to all price cap carriers.

The Commission also has pending dockets, such as CC Docket No. 93-240, Accounting for Judgments and Other Costs Associated with Litigation,^{136/} and CC Docket

^{134/} See Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Adjustment Formula, 8 FCC Rcd 4415 (1993).

^{135/} See Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Report and Order (released Oct. 20, 1993).

^{136/} See Accounting for Judgments and Other Costs Associated with Litigation, 8 FCC Rcd 6655 (1993).

No. 93-251, Affiliate Transactions,^{137/} in which onerous new cost accounting rules are proposed that are virtually meaningless under a pure price regulation regime. Adoption of pure price regulation for the LECs in this proceeding would allow the Commission to dispose of those proceedings without further consideration.

Adoption of a pure price cap plan will permit the Commission to eliminate its reliance on burdensome and economically inefficient cost allocation and reporting requirements. A pure price cap plan eliminates any need for the carriers to allocate costs, and permits pricing decisions based on sound economic principles. Uneconomic pricing decisions would simply reduce a carrier's profits. Ratepayer protection against rate shock in the plan would be retained by the revised basket and band rules proposed herein by BellSouth.

Adoption of pure price regulation would also permit the Commission and the carriers to examine many other Commission rules and proceedings to determine whether additional regulatory simplification is possible. BellSouth will work closely with the Commission to identify additional areas where administrative savings for both the Commission and carriers are possible, thereby achieving one of the unfulfilled promises of price cap regulation.

IV. TRANSITIONAL ISSUES

Transition Issue 1: Criteria for Reduced Or Streamlined Regulation Under Price Caps

The Commission reasons that the most likely basis for applying more streamlined regulation to the LECs is that the LECs' market power has been reduced and that

^{137/} See Amendment of Part 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251 (released Oct. 20, 1993).

access exchange competition has increased.^{138/} The Commission requests comment on the current state of competition in providing local exchange and interstate access, and the most useful criteria for determining when to adopt streamlined regulation. After assessing the current state of competition for local exchange and interstate access in its own service territories, BellSouth below presents a specific approach and criteria for determining when streamlined regulation for price cap LECs should take effect. BellSouth has been aided in this effort by Dr. John Haring and Dr. Jeffrey H. Rohlfs of Strategic Policy Research, whose comments are attached hereto as Attachment 1.

Transition Issue 1a:

What is the current state of competition for local exchange and interstate access?

Competitive services exist, to some extent, in virtually all areas of BellSouth's business -- access, private line, toll, operator, and to a more limited degree, local services.^{139/} There has been and will continue to be a high correlation between geographic concentration of revenues and the level of competition. Initially, competitors typically target densely populated areas and business districts of metropolitan areas.^{140/}

Access and Private Line Services

Facility bypass via private networks such as fiber, microwave, and Very Small Aperture Terminals (VSAT) occurs throughout the BellSouth region. Vendors offer bypass services in selected areas. As of July 1993, over 60 businesses were using VSAT systems in lieu of BellSouth services in over 7,600 locations in the region. As of early 1993, there

^{138/} Notice at 40, ¶ 95.

^{139/} For a more general assessment of the status and trends in competition facing the LECs, see Harris Report, Appendix B, "Competition in Access and Exchange Services"; see also SPR Vision Paper at 5-13.

^{140/} Attachment 2 hereto shows the distribution of revenues throughout the BellSouth region.

were over 400 private fiber installations and hundreds of private microwave systems in the region other than BellSouth private line and access services.

Competitive access providers (CAPs) have targeted the largest metropolitan areas throughout the region to build fiber networks and provide private line and access services to both end users and interexchange carriers (IXCs).^{141/} Recent FCC actions on access collocation and interconnection will permit end users, as well as competitors, to utilize BellSouth facilities rather than having to build their own private networks. The CAP customer base can be expanded far beyond the customers currently served by existing fiber networks.

Toll and Operator Services

Resellers have enjoyed intraLATA capability since divestiture, initially through switched access services including feature groups A and B, and then 10XXX dialing, special access, and 700/800/900 call origination. With the exception of 10XXX access, all of these methods of call origination avoid BellSouth central office screening. Initially resellers utilized local exchange company WATS and MTS services as their resale medium. However, shortly after divestiture resellers abandoned that practice, and completed intraLATA traffic strictly through the use of access services. The historical distinction between resellers and IXCs continues to have meaning only in a regulatory context.

Over time, IXC intraLATA capability has increased through a similar progression. All of the BellSouth state PSCs have allowed intraLATA toll competition on a 10XXX basis by IXCs, and two of them are addressing 1+ intraLATA presubscription. Using a combination of BellSouth switched and special access services, along with their own or leased intraLATA facilities, IXCs and resellers complete intraLATA calls. In many

^{141/} Attachment 2 also contains detailed CAP network information. Attachment 3 presents a summary of CAP activity throughout the BellSouth region.

cases, only BellSouth access services are used, i.e., access service to originate an intraLATA call and deliver it to the IXC or reseller POP and then also to deliver the call to its destination within the LATA. As a result, IXCs and resellers are not limited by the scope of their own facilities in the provision of intraLATA toll services.

New service introductions by toll and operator services competitors typically include completion of intraLATA calls in innovative ways, e.g., through the use of debit cards that employ 800 access for call origination or dialing arrangements such as 1-800-COLLECT. Long distance companies have increased their focus on the consumer market, targeting residential and small and medium business customers with innovative long distance billing packages. 800 number portability (May 1993) fueled an upsurge in 800 Service competition among the various competitors vying for an increased share of that highly competitive market.^{142/}

Local Services

Customer Owned Coin Operated Telephone (COCOT) providers have made significant inroads into BellSouth's pay telephone services, targeting customers with large call volumes, e.g., airports, shopping malls, truck stops, convenience store chains, and prisons. Since the authorization of COCOT competition in the 1985-86 timeframe, COCOT providers have captured approximately thirty percent of the public telephone market (based on lines) in BellSouth territory. The locations captured are the generally more profitable ones. Employing BellSouth COCOT access lines, along with BellSouth line features to facilitate delivery of services, smart payphone sets, and the services of long distance and operator services providers, COCOT providers deliver a full range of services that compete with BellSouth services.

^{142/} Attachment 4 presents a summary of the status of intraLATA toll competition by state within the BellSouth region.

The market for business telephone systems continues to be a highly competitive arena for ESSX^R Service. The overall market is dominated by Private Branch Exchange (PBX) and key telephone system vendors, particularly in the higher growth medium and small business markets. PBX and key equipment is a direct replacement for BellSouth central office-based ESSX services.

On a more limited basis, Shared Tenant Services (STS) providers present alternatives to BellSouth local exchange services in selectively targeted markets. By aggregating business or residential users and furnishing exchange service over resold PBX trunks, STS providers displace BellSouth central office-based features and functions with PBX switch features.

Deployment of digital cellular technology and development of wireless data capabilities have considerably increased the capacity and the scope of cellular service applications. Over the past few years, decreased cost has led to significantly decreased prices for both cellular equipment and services. Cellular service has experienced dramatic growth, surprising many industry analysts. In 1986, Herschel Shosteck Associates forecasted a total of 1.5 million cellular users in the U.S. by 1990.^{143/} The actual 1990 figure was 5.3 million. As of the end of 1993, approximately 16 million people had cellular phones.^{144/} Current projections estimate approximately 100 million wireless users in the United States by the year 2000.^{145/}

^{143/} Herschel Shosteck Associates, Ltd., The Demand for Cellular Telephone, National and Metro Markets: 1985 - 1995, (Dec. 1985), at 63.

^{144/} See Harris Report, Appendix B, "Competition in Access and Exchange Services," at Table B-8.

^{145/} See Statement of Thomas A. Stroup, President, Personal Communications Industry Association, Attachment, "PCS Technologies Forecast" (April 11, 1994) (submitted in FCC Gen. Docket No. 90-314).

While cellular services currently must be regarded primarily as complements for traditional local services, in many cases they are clearly substitutes. Calls which would normally be placed on business or residence landline services are often made over cellular facilities because of the convenience of wireless technology. As the size of cellular service areas grows beyond existing local calling areas, and cellular providers offer discounted calling packages, LEC long distance services are also being displaced.

Transition Issue 1b:

What criteria if any should be used for determining when reduced or streamlined regulation for price cap LECs should take effect?

The fundamental goal of regulation is to replicate the outcomes that would occur in the competitive marketplace. Accordingly, where competition prevails, regulation becomes unnecessary and, indeed, can be counterproductive. Recognizing that effective competition will not occur simultaneously in all market segments and in all geographic areas, the Commission's rules should provide for streamlined regulation when it can be demonstrated that particular market segments face effective competition.

With respect to the criteria for assessing the presence of effective competition, Haring and Rohlfs have observed that the key criterion for determining effective competition, in economic terms, is **resource mobility**.^{146/} Resource mobility implies a high elasticity of supply. The more elastic the prevailing conditions of supply, the less it is possible to raise prices by limiting output. In those circumstances characterized by a high elasticity of supply, even small price increases will result in large output expansions.

As Haring and Rohlfs point out, while the elasticity of supply in a market -- a measure of resource mobility -- is determined by a variety of factors, the conditions of entry

^{146/} Haring/Rohlfs Report at 18.

into the market are of "prime importance."^{147/} The market cannot be characterized as effectively competitive to the extent that important economic barriers to these conditions exist in a market and other uneconomic barriers are artificially maintained. On the other hand, to the extent that as many barriers to entry as can be removed are removed, a fair opportunity for self-policing competition to evolve is created.^{148/}

While resource mobility may be a necessary condition for effective competition, it may not be a sufficient condition from the Commission's perspective. The Commission will likely desire evidence of the existence of actual competition as a trigger for regulatory relief.^{149/} In applying this standard with respect to exchange access, BellSouth believes that it would be inappropriate and contrary to the public interest for the

^{147/} Haring and Rohlfs elaborate:

In particular, are conditions of entry such that resources can, in timely fashion, be brought to bear to offset any output restriction? If there are legal barriers that prevent additional resources from being deployed or access to critical resources is unavailable or available only on an unfavorably discriminatory basis, entry will be more difficult than in the absence of such conditions. Indeed, entry may be impossible under such circumstances. If entry must be undertaken on a substantial scale relative to the size of the market and requires investments in specialized, nonsalvageable capital resources, entry will be more difficult in the absence of such conditions and may again prove to be impossible in some circumstances. If a market is populated by several suppliers with excess capacity or the ability to quickly expand existing capacity, expansion in market or into neighboring markets may be easier than in the absence of such conditions.

Id. at 18.

^{148/} See id. at 19.

^{149/} Haring and Rohlfs explain:

A conclusion that competition is effective in any particular market will ultimately reflect the existence of actual competitors competing successfully. Competition in this sector of the economy generally requires significant investments in specialized (*i.e.*, nonsalvageable) capital assets. Hence (a finding of) effective competition probably will require not only that the market is as contestable as is economic to arrange, but also that a significant portion of the market is actually contested.

Id. at 20 (footnote omitted) (emphasis in original).

Commission to adopt a market share trigger for streamlined review.^{150/} BellSouth proposes that the Commission instead employ a measure of productive capacity deployment as evidence of competition's presence. Dr. Haring and Dr. Rohlfs also advocate such a productive capacity measure.

Based on a showing that the conditions for competition exist, LECs should be able to petition the Commission for streamlined regulation. The LEC would identify the geographic area (e.g., the contiguous geographic area served by a group of wire centers) for which there are competitors.^{151/} The petition would further identify the services subject to competition and demonstrate effective competition based on the competitors' productive capacity to serve the market area.

This approach is endorsed by Dr. Haring and Dr. Rohlfs and provides a reasonable framework for the Commission to adjust regulation commensurate with competition. Certainly, as barriers to competition are removed, the risk of unreasonable behavior is substantially lessened. The approach leading to streamlined regulation outlined above and in the Haring/Rohlfs Report is a means by which the Commission can satisfy itself that the marketplace is a credible control mechanism and therefore that regulatory controls (e.g., price cap regulation) can be relaxed.

^{150/} Specifically, as Haring and Rohlfs explain, a market share trigger "rewards and thereby encourages noncompetitive behavior"; encourages strategic behavior by new competitors in the particular market; is inherently arbitrary; and compromises the trigger's meaning and utility as a gauge of competition. *Id.* at 21-22; see SPR Vision Paper at 27 ("Market-share tests have limited value as indices of market power. In addition, using market-share tests for regulatory purposes perversely creates incentives for the incumbent firm to fail.").

^{151/} Attachment 5 hereto provides an illustrative example of how a competitive market would be determined.

Transition Issue 1c:

In what circumstances will a LEC no longer control essential "bottleneck" facilities for some or all of its services? How will the Commission be able to identify these circumstances in practice?

The Commission's inquiry regarding the circumstances in which a LEC will no longer control essential bottleneck facilities is somewhat off the mark. The notion of the local bottleneck, while once having a basis in fact, is today grossly exaggerated in its importance and reality. As Professor Robert Harris observes, the emergence of powerful competitors and market forces has "swept away" the former "natural monopoly" of local exchange carriers:

Unfortunately, the myth of the monopoly remains, perhaps because it serves so well the interests of those who would prefer to compete with local exchange carriers constrained by regulatory restrictions and obligations, while they are not.^{152/}

BellSouth agrees with Professor Harris that in this proceeding, the Commission should "reap the harvest of competition, by freeing local exchange carriers from regulations that are no longer necessary and increasingly counter-productive."^{153/}

In any event, however, there is no need to debate the issue in order for the Commission to act on BellSouth's proposals in this proceeding. BellSouth's baseline proposals are appropriate independent of the level of competition in the local exchange marketplace. They are intended to improve the performance of price regulation. Because price regulation is a transition mechanism to competition, improvements in the plan will hasten the development of competition.

^{152/} Harris Report at 10 (emphasis in original); see also Peter Huber, The Enduring Myth of the Local Bottleneck (Mar. 14, 1994) (already submitted by Pacific Telesis in this docket).

^{153/} Harris Report at 10.

Likewise, BellSouth's proposal for streamlining regulation establishes criteria wherein the LEC would be required to show that specific market segments are contested. Any LEC that was able to satisfy the streamlining criteria, would by definition, have demonstrated that there is no bottleneck in the market segment. Accordingly, the Commission need not attempt to develop some special regulatory method for measuring the control of "bottleneck" facilities. Instead, the Commission should focus on adopting a regulatory framework which adjusts the degree of regulation as competition takes hold. BellSouth's proposals provide such a framework.

Transition Issue 1d:

What ability do CAPs and others have to compete with the LECs? What data indicate the level of actual and potential competition from CAPs and other providers? For example, such data may include the CAPs profit levels, stock price trends, revenues, or other measures which reflect the CAPs ability to compete.

CAPs are by no means the only source of emerging competition to the LECs. In fact, increased competition for traditional local exchange company services, including access and local service, is rapidly emerging on numerous fronts.^{154/} Alliances and acquisitions among traditional and non-traditional telecommunications providers are changing the whole market structure.^{155/} These alliances, together with regulatory and technological changes, are giving IXC's an increased ability to compete in the traditional LEC service arena. They are also spurring the entry of new, non-traditional providers in addition to CAPs -- such as cable television companies, other local telephone companies, power companies, and municipal governments -- into this arena as well. Additionally,

^{154/} See *id.*, Appendix B.

^{155/} Attachment 6 provides a summary of major activity in this area.

developments in the wireless arena indicate that such services will provide major competition for traditional LEC local service.

Interexchange Carriers

Alliances such as AT&T/McCaw, Sprint/Centel, and MCI/British Telecom/Nextel will significantly expand the scope of IXC operations, either through vertical integration or through the infusion of capital to fund new ventures. AT&T's proposed merger with McCaw Cellular Communications would result in AT&T's re-entry into the local exchange business through McCaw's extensive cellular holdings throughout the country. Obviously, the combination of long distance services with cellular services provides a significant marketing advantage for AT&T. Sprint already has significant cellular holdings through its merger with Centel.

As announced on January 4, 1994, MCI has targeted the twenty largest cities in the United States for construction of fiber rings and local switching infrastructure. Its new wholly-owned subsidiary, MCI Metro, will invest \$2 billion in major metropolitan markets to connect directly to customers and provide alternative local telecommunications services. Through the purchase four years ago of Western Union rights of way in about 200 cities nationwide, MCI is also positioned to enter substantially more markets throughout the region.

MCI Metro is only part of MCI's broader long range vision, networkMCI, which includes an investment of more than \$20 billion in MCI's transcontinental information superhighway. Within the BellSouth region, MCI has initially targeted Atlanta, Miami and Fort Lauderdale for deployment of local fiber networks. Although initially planning to provide business services, MCI has said that it will expand its network, offering phone service to residential customers, as well as business customers.

As another part of networkMCI, at the end of February, MCI, Nextel Communications, Comcast Corporation, and Motorola Inc. announced the formation of a

strategic alliance to begin offering wireless services nationwide. A \$1.3 billion MCI investment in Nextel will match Comcast's ownership, and will accelerate the first nationwide offering of digital wireless voice and data communications services to consumers, business and government customers. The alliance will capitalize on Nextel's existing licenses or agreements covering 95% of the U.S., Comcast's cable television and cellular expertise, and Motorola's technology platform and subscriber equipment, along with MCI's marketing skills and intelligent network.

Competitive Access Providers

FCC actions on collocation and expanded interconnection were designed to foster further interstate access competition and will undoubtedly increase intrastate access and private line services competition as well. Interconnection and collocation will permit competitors, as well as end users, to utilize LEC facilities rather than having to build their own networks. Market entry by CAPS will be greatly facilitated and the ability of IXC's to obtain alternatives to LEC access services will increase significantly.

CAP activity within the BellSouth region continues to increase (see Attachments 2 and 3). Late last year Time Warner joined Cox Enterprises, TCI, Continental, and Comcast in their ownership of Teleport Communications Group, the second largest CAP in the country. The result is a national CAP with cable television ownership spanning the country with a facility base in many dispersed market areas. These cable television companies have formed a joint venture to create metropolitan areawide communications networks to compete directly with telephone companies, and plan to recruit other cable television participants. The venture will be organized on three levels, with ownership of each different: a) a nationwide umbrella organization that would provide support services for local joint ventures; b) "line-of-business" joint ventures for each type of

service, e.g. PCS; and c) local ventures that would interconnect systems, allowing new communications services to be transmitted to a national network.

CAPs operating within the BellSouth region such as MFS, Intermedia Communications, City Signal, and IntelCom Group have expanded the range of their service offerings beyond basic dedicated services to include numerous high speed data services and have shifted their marketing focus to include end users as well as IXC's. Both inside and outside the BellSouth region, CAPs continue to expand the scope of their businesses.

Cable Television Companies

The major cable television companies have announced their intentions to upgrade their networks and to provide telephony over cable television facilities, as well as a multitude of video services. These announced intentions strongly show a dramatic acceleration toward cable television-provided alternatives to local service. Over ninety percent of American homes are passed by cable television facilities and cable television subscribership is over sixty percent.

Fueled by funding and expertise provided by alliances such as US West/Time Warner, Nynex/Viacom, and BCE/Jones, cable television companies are preparing their networks, nationwide and within the BellSouth region, to provide a full range of services. Even prior to the announcement of the ill-fated Bell Atlantic/TCI merger and Southwestern/Cox mergers, TCI had announced plans to spend \$1.9 billion to upgrade its networks by 1996 and Cox had already begun major network upgrades. After the collapse of the Bell Atlantic merger, TCI moved rapidly to formulate a new strategy which includes plans to equip all of its cable television systems to provide residential telephone services by the end of 1994-95 time frame, a potential joint venture with either AT&T or MCI, and a joint venture with software manufacturer Microsoft to launch a cable television channel aimed at personal computer users.

US West has targeted one billion of its \$2.5 billion investment in Time Warner to accelerate the building of full service networks, expected to be completed by 1998 for the majority of Time Warner's cable systems. The first such "Full Service Network" in Orlando, Florida, originally scheduled to be operational by April 1994, has been delayed until fourth quarter 1994 because of equipment delays. Initial services to be provided include video-on-demand, interactive games, distance learning, full motion video, interactive shopping, Personal Communications Service (PCS), video conferencing, high speed data services and long distance telephone service. The capability of the network, however, goes much further. It will include AT&T switching capability and Qualcomm Code Division Multiple Access (CDMA) wireless technology.

In Queens, New York, a trial to provide telephone services over the cable television network owned by the Time Warner New York City Cable Group was recently completed. Customers were directly connected to MCI for long distance service, bypassing the LEC completely. In Canby, Oregon, the Canby Telephone Association and North Willamette Telecom, the cable television operator, deliver both cable television and telephone service over the same cable. This past November, MCI, Jones Lightwave, and Scientific-Atlanta announced the trial of telephony over cable television. Using Scientific-Atlanta's CoAccess technology, the companies will provide long distance service in Alexandria, Virginia and local and long distance service in Chicago over cable television facilities.

Power Companies

Power companies within the region, such as The Southern Company and Entergy have established alliances that will facilitate their entry into telephony. Power companies use their own fiber optic and microwave networks to monitor and control their power transmission and distribution systems. Since they often use only a small portion of the total capacity of their networks for internal purposes, many market the excess capacity,

either as private carriers offering dry fiber to third parties or providing telecommunications services directly to end users.

Entergy filings before the Louisiana and Mississippi PSCs and the New Orleans City Council have proposed the placement of a fiber and coax network to provide Demand Side Management functions. Initially, Entergy had proposed that the cost would be borne by electric utility ratepayers. Entergy now plans to implement the initial phase of its pilot program to provide an opportunity to determine the benefits of the program without risk to electric utility ratepayers. This architecture has the capability of handling voice traffic, and is the arrangement being trialed by Entergy and Sprint in Chenal Valley, Arkansas.

In South Carolina, MPX Corp., a subsidiary of SCANA, operates fiber networks used by South Carolina Electric & Gas Company and nine other utilities owned by SCANA. The networks serve medium-sized cities in South Carolina, North Carolina, Alabama, and Georgia. Since the utilities use less than twenty-five percent of the network capacity, MPX provides services to IXC's but does not serve end users. MPX has stated that it is not opposed to partnership agreements with telephone companies and cable television operators to obtain broadband capability into the home to provide energy management services.

Baltimore Gas & Electric Company (BG&E) is certified by the Maryland Public Service Commission to provide intrastate interexchange services, and it provides interstate special access services to IXC's and directly to end users. Officials at BG&E indicate that it has the potential to offer switched local exchange services.

Municipal Governments

Municipal governments across the country are playing various roles in the development of expanded competition within the telecommunications industry. When Electric Lightwave, a CAP, sued the city of Seattle, Washington for use of city utility poles,

the city decided to open its right of way to all comers who might want to build, own and operate a broadband network with the requirement that the network be accessible to all residents, businesses, and institutions. The city of Glasgow, Kentucky is taking a much more active role. The municipal Electric Plant Board (EPB) in Glasgow, Kentucky provides both cable television and telephone services over the same coaxial cable facilities. The EPB provides residential telephone service to about sixty customers and also provides data services to local schools. As of early January 1994, the municipal government is ready to begin offering local exchange service to commercial customers over its cable television system, directly competing with General Telephone, the LEC. MCI was preparing to trial a long distance application. As of September 1993, almost three hundred municipal and private power companies had requested information on Glasgow's system. Ruston, Louisiana officials have visited Glasgow and are studying a similar plan. In August 1993, the city approved a feasibility study on the possible benefits of installing a fiber optic broadband network. Although the initial interest is in the area of electric power management, city officials are aware of other potential applications for the network. The city of Orangeburg, South Carolina has deployed a fiber network for energy management functions but is examining other possible uses for the network. The New Orleans City Council has considered a proposal for a municipal broadband fiber network. Although the Council decided against the proposal, it will play a significant role in determining how the information superhighway develops in New Orleans. The Council has indicated its intent to allow as many players as possible to compete.

Wireless

Rapid technological developments in the area of wireless communications will continue to have significant impact on local competition. As the prices of digital microwave and Very Small Aperture Terminal ("VSAT") facilities have declined and the applications for

these bypass technologies have increased, more customers have utilized such alternatives for a wider range of services. Recent enhancements permit the use of VSAT for voice applications as well as broadcast-quality video.

Other wireless technology developments will also affect local competition. Late last year, Motorola sold Nextel its vast patchwork of specialized mobile radio services which can be upgraded with digital technology that makes them almost indistinguishable from cellular phone networks. Nextel had been buying up dispatch services around the country and planned to upgrade these systems with technology developed by Motorola, well before the announcement of the strategic alliance with MCI.

There has been a flurry of activity recently in the area of satellite communications. US West recently began a trial of a satellite-based phone service in Wyoming to test using satellites to improve rural service. Using the General Motors Hughes Electronics Galaxy VII communications satellite and its earth stations, US West expects to provide rural service more cheaply than constructing physical facilities over rough terrain. A Motorola-backed venture, Iridium Inc., is trying to establish a world-wide satellite system by 1998. It would include voice, data, and fax capabilities. Hughes Communications filed an FCC application for its Spaceway™ satellite service, planning to offer high-speed data and video telephony services to the business and consumer markets by 1998. Further demonstrating the appeal of satellite communications, Craig McCaw, of McCaw Cellular, and Bill Gates, founder of Microsoft, have formed a new company called Teledesic. They plan to put 840 satellites in low orbit, forming the first digital, wireless network that could transmit voice, interactive video, and high speed data anywhere in the world.

Regulatory developments at the FCC such as the adoption of rules for regulating and licensing Personal Communications Service (PCS) and the granting of "pioneer's preference" awards and experimental PCS licenses, along with strategic alliances

such as the AT&T/McCaw merger and MCI/Nextel/Comcast/Motorola, will undoubtedly have significant impacts on the extent of competition in telecommunications. All the major cable television network upgrade plans include wireless technology. Along with the dramatic growth in existing wireless services, convergence in the industry will serve to provide alternative means of access to end users for other competing services as well as alternatives for basic local service.

Additional Considerations

Many of the major cable television providers now have financial backing and technical expertise from Regional Holding Companies that are well experienced in the provision of telephone services. Electric utility companies already have right of way. IXC's have right of way, switches in place, and financial backing. Many emerging competitors have substantial wireless interests. National alliances and consortia such as MCI/Nextel and the Teleport/TCI/Cox/Comcast/Continental/Time Warner consortium serve to provide a broader base from which competitors can operate. Anticipated changes such as the North American Numbering Plan (NANP) revisions, pending federal legislation, and National Information Infrastructure (NII) initiatives will serve to increase the ease with which competitive entry and operation by multiple providers offering many similar services will occur.

Cable television companies, CAPS, IXC's and power companies are upgrading their networks with fiber and hybrid fiber/coax architectures driven by advances and developments in those industries, such as digital compression, interactive video, multimedia, and energy management. Such network architectures are capable of providing a full range of services well beyond the scope of these existing businesses. Coupled with advances in technology that enable the joint provision of voice and video or utility management services over the same facilities, competition for traditional LEC services is emerging on numerous

fronts. The new participants in this increasingly competitive market are well established firms with the technological ability, financial resources, and market experience to successfully deliver new applications to the mass market.

Transition Issue 1e:

What impact should price cap LEC entry into related industries (e.g., cable TV) and BOC entry into inter-LATA marketplaces have on the LEC price cap plan?

To the extent price cap LECs are permitted to enter new markets, such as cable television or interexchange, such entry should not affect the LEC price cap plan. A hallmark of an effective price plan is that it severely curtails the ability of firms to cross-subsidize or engage in other anticompetitive behavior that might otherwise generate concern about their entry into related industries. Moreover, as LECs are permitted to enter currently foreclosed lines of business, it must be recognized that in those markets the LECs will be new entrants without market power. Indeed, LECs should be assigned a regulatory status of "nondominant" in such markets. Because the LEC price cap plan regulates the prices of LEC access services, no adjustment to that plan would be needed to accommodate price cap LECs entering these other markets.

Transition Issue 2: Transition Stages

What regulatory methods for reducing price cap regulation or streamlined regulation should be adopted for LEC services as those services become subject to greater competition?

Competition requires that regulation be adjusted to allow the marketplace to operate as the ultimate constraint on the pricing behavior of the firm. With effective competition, streamlined regulation with minimal Commission involvement is appropriate. Even as competition develops, however, regulation should be adjusted to recognize that certain regulatory controls or constraints may no longer be needed or that they may be eased.

In response to the baseline issues, BellSouth described a modified price cap basket and banding structure that would afford LECs a greater amount of flexibility than the current rules provide. These modifications, however, were not premised on the existence of competition or any regulatory policy that promotes competition. That is, the proposed modifications are appropriate regardless of the status of competition. They improve the efficiency of the price cap plan but still provide the Commission with adequate controls to assure that prices fall within a zone of reasonableness.

As the Commission takes steps to foster competition for exchange access services, then the price cap rules should be relaxed to provide greater flexibility in recognition of other regulatory actions of the Commission. As competition develops, the Commission must maintain a regulatory balance that ultimately is achieved through streamlined regulation.

There are several regulatory events that should be counterbalanced by an adjustment to the basket and banding structure of the price cap plan. They are: expanded interconnection for transport services, expanded interconnection for tandem switching and revisions to the North American Numbering Plan. As each occurs, they should be followed by immediate and automatic revision to the price cap rules. BellSouth proposes the following adjustments:

1. **Expanded interconnection for transport** -- Transport expanded interconnection should be counterbalanced by additional pricing flexibility for dedicated transport services. Such flexibility would be accomplished by increasing the lower pricing limit for the dedicated transport service category from five percent to fifteen percent. In addition, the subcategories for high capacity services and other services would be eliminated.
2. **Expanded Interconnection for Tandem Switching** -- Should the Commission in Phase II of CC Docket 91-141 order expanded interconnection for tandem switching, the pricing flexibility for LEC provided tandem switched transport should be increased. BellSouth proposes that the lower pricing limit for tandem switched transport be increased to fifteen percent.